

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**FINANCIAL ACCOUNTING FOR THE
DEFENSE INVESTIGATIVE SERVICE**

Report No. 98-059

February 3, 1998

Department of Defense

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Acronyms

BQ	Air Force Base Level General Accounting and Finance System
DAO	Defense Accounting Office
DIS	Defense Investigative Service
DFAS	Defense Finance and Accounting Service



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February 3 , 1998

**MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
DIRECTOR, DEFENSE INVESTIGATIVE SERVICE**

**SUBJECT: Audit Report on Financial Accounting for the Defense Investigative
Service (Report No. 98-059)**

We are providing this report for review and comments. We performed the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Because the Defense Finance and Accounting Service and the Defense Investigative Service did not comment on the draft of this report, we request that they provide comments on this final report by April 3, 1998.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Charles J. Richardson, Audit Program Director, at (703) 604-9582 (DSN 664-9582), e-mail CRichardson@dodig.osd.mil, or Mr. Marvin L. Peek, Audit Project Manager, at (703) 604-9587 (DSN 664-9587), e-mail MPeek@dodig.osd.mil. See Appendix C for the report distribution. The audit team members are listed inside the back cover.

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Assistant Inspector General
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Office of the Inspector General, DoD

Report No. 98-059
(Project No. 7RF-2019)

February 3, 1998

Financial Accounting for the Defense Investigative Service

Executive Summary

Introduction. The audit was performed in support of our audits of the FYs 1996 and 1997 DoD-wide financial statements required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Financial data from the Defense Investigative Service are included in the "Other Defense Organizations" portion of the DoD consolidating financial statements. The Defense Investigative Service received \$211.8 million and \$203.8 million in direct appropriated funds during FYs 1996 and 1997, respectively. The FY 1996 financial statements for the Defense Investigative Service showed \$123 million in assets, \$120 million in liabilities, and \$211 million in expenses. The Defense Finance and Accounting Service Denver Center provides accounting support for the Defense Investigative Service.

Audit Objectives. The overall objectives of the audit were to assess internal controls and compliance with laws and regulations that require the production of accurate financial statements. We also reviewed FY 1996 account balances submitted to the Defense Finance and Accounting Service Indianapolis Center and supporting documentation for FY 1997 transactions and account balances.

Audit Results. Accounting information reported for the Defense Investigative Service for FYs 1996 and 1997 was materially incomplete and inaccurate and could not be fully supported. As a result, financial information produced and reported for the Defense Investigative Service could not be relied on to prepare accurate financial statements required by the Chief Financial Officers Act of 1990. Also, at least \$3.5 million of invalid liabilities and obligations from the FYs 1993 through 1997 Operation and Maintenance appropriations needed to be removed from the Defense Investigative Service's accounting records. Those expired funds could be used for adjustments to valid obligations, if needed. See Appendix A for details of the internal control program.

Summary of Recommendations. We recommend that the Defense Finance and Accounting Service Denver Center and the Defense Investigative Service locate or reconstruct missing documentation for obligations and accounts receivable, establish internal controls to validate all unliquidated obligations and accounts receivable, establish controls to prevent duplication obligations from being recorded, and report liabilities for unfunded annual leave in the financial statements. We also recommend that the Defense Finance and Accounting Service Denver Center adjust liabilities incorrectly recorded in prior years to reflect only accruals of goods and services received, and use established procedures to follow up on delinquent accounts receivable.

Management Comments. The Defense Finance and Accounting Service and Defense Investigative Service did not comment on a draft of this report. Therefore, we request that those organizations provide comments on this final report by April 3, 1998.

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Part I - Audit Results

Audit Background

Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, requires Federal organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, “The Federal Financial Management Act of 1994,” October 13, 1994, requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. Financial data from the Defense Investigative Service (DIS) is included in the “Other Defense Organizations” portion of the DoD consolidating financial statements. During FYs 1996 and 1997, DIS received \$211.8 million and \$203.8 million, respectively, in direct funding. The FY 1996 financial statements for DIS showed \$123 million in assets, \$120 million in liabilities, and \$211 million in expenses.

Accounting and Reporting for the Defense Investigative Service. In March 1993, the Defense Finance and Accounting Service (DFAS) assumed responsibility from DIS for financial accounting and reporting for DIS. At that time, DFAS established a Defense Accounting Office (DAO) at Headquarters, DIS, Alexandria, Virginia. That DAO reported to the DFAS Denver Center from the time the DAO was established in 1993. DFAS personnel used the same accounting system previously used by DIS and entered transactions into the system based on information provided by DIS. In November 1996, the DFAS Denver Center consolidated the DAO at Headquarters, DIS, into the DFAS Denver Center’s newly formed Finance and Accounting Operations Directorate, which performs accounting functions for DIS. The DFAS Denver Center forwards DIS accounting and budgetary information to the DFAS Indianapolis Center, which prepares the monthly “Report(s) on Budget Execution” and financial statements for DIS.

Audit Objective

The overall objectives of the audit were to assess required internal controls and compliance with laws and regulations related to producing accurate financial statements. We also reviewed FY 1996 account balances submitted to the DFAS Indianapolis Center and supporting documentation for FY 1997 transactions and account balances.

Financial Accounting and Reporting

Accounting information reported for DIS for FYs 1996 and 1997 was materially incomplete and inaccurate and could not be fully supported. This occurred because DIS and the DFAS Denver Center:

- o incorrectly accrued liabilities in prior years when funds were obligated, regardless of whether goods or services had been received;
- o did not periodically validate unliquidated obligations, liabilities, and accounts receivable;
- o could not provide documentation to support \$52.8 million in liabilities and \$1.8 million in accounts receivable included in judgment samples;
- o included \$0.8 million in duplicate obligations in FY 1997 accounting records;
- o did not report a liability for unfunded annual leave (the balance was \$11.8 million in April 1997); and
- o did not report all required information to the DFAS Indianapolis Center.

As a result, financial information produced and reported for DIS could not be relied on to prepare accurate financial statements required by the Chief Financial Officers Act of 1990. Also, at least \$3.5 million of invalid liabilities and obligations from the FYs 1993 through 1997 Operation and Maintenance appropriations needed to be removed from DIS accounting records. Those funds could be used for adjustments to valid obligations, if needed.

Accounting Records for the Defense Investigative Service

Since March 1993, the DFAS Denver Center has been responsible for the accounting function for DIS, except for travel-related expenses. DIS personnel became responsible for recording obligations and accruals for travel-related expenses when the DAO at Headquarters, DIS, moved to the DFAS Denver Center on November 1, 1996. DIS transactions are recorded in the Air Force Base Level General Accounting and Finance System (BQ). The BQ system is not a double-entry accounting system, and it does not produce a general ledger using the DoD Uniform Chart of Accounts. The BQ system maintains open transactions in an Open Document Listing. For each transaction, the listing shows a system-generated identifying number, the Element of Expense and Investment Code, unliquidated obligations, accounts payable and receivable, receipts and expenditures, and the date of last activity. The Open Document

Financial Accounting and Reporting

Listing provides data for the Allotment Ledger, which shows expenditures by Element of Expense and Investment Code. Information from the Allotment Ledger supports the monthly "Report(s) on Budget Execution."

The DFAS Denver Center is developing a new accounting system, the Defense Joint Accounting System. Personnel at the DFAS Denver Center plan to begin deploying the new accounting system in FY 2001, with completion scheduled for the end of FY 2002.

Accrual of Liabilities

Before FY 1997, DIS policy, which was implemented by the DAO at Headquarters, DIS, was to simultaneously obligate funds and accrue liabilities, whether or not a liability existed. In early FY 1997, DFAS and DIS personnel corrected that accounting policy¹ and began to accrue liabilities only upon receipt of documentation that a liability existed. However, DFAS personnel did not adjust liabilities previously recorded to reflect the actual accrual of liabilities. As a result, DIS liabilities recorded in the BQ system were unreliable because DIS and DFAS Denver Center personnel did not have documentation to show the goods and services had been received. Neither DIS nor DFAS Denver Center personnel could provide documentation to show the validity of \$52.8 million in liabilities included in judgment samples for FYs 1992 through 1996 Operation and Maintenance appropriations (see Appendix A).

Validity of Obligations for Accounts Payable

The accounts payable recorded before FY 1997 generally were not valid because DFAS Denver Center and DIS personnel incorrectly recorded liabilities when they established obligations. The \$36.2 million in obligations for the accounts payable (excluding travel- and payroll-related liabilities) for FYs 1992 through 1996 appropriations were also overstated, unsupported, or questionable because DIS did not have effective controls for reviewing the validity of these obligations as required.

Requirement for Periodic Validation. An Under Secretary of Defense (Comptroller) policy memorandum, "Quarterly Reviews of Commitments and Obligations," May 14, 1996, requires that all funds holders and accounting offices review and confirm the accuracy of unliquidated obligations at least

¹Key accounting requirement No. 5, "Accrual Accounting," from DoD 7000.14-R, the "DoD Financial Management Regulation," volume 1, May 1993, requires liabilities to be recorded on an accrual basis when they occur, or to be adjusted to the accrual basis at the end of each month. Accrued expenditures and liabilities must be recorded only when supported by documentary evidence.

3 times a year for accounts of \$50,000 or more, and at least annually for all accounts. The accounting office is required to provide the funds holders with listings that identify unliquidated obligations requiring review, and the funds holders are required to review such obligations and determine their accuracy and validity. For Operation and Maintenance appropriations, the memorandum defined dormant accounts as being inactive for 120 days.

Extent of Dormant Accounts. Of the \$36.2 million in accounts payable (excluding travel- and payroll-related liabilities) for FYs 1992 through 1996 Operation and Maintenance appropriations, accounting records showed that \$24 million in obligations had no transactions posted for 120 days to 5 1/2 years, as shown in Table 1. Transactions were posted during the past 120 days for the other \$12.2 million in accounts payable.

Table 1. Accounts Payable With No Transactions

<u>Time With No Transactions</u>	<u>Number of Accounts</u>	<u>Liability (millions)</u>
120 days to 1 year	718	\$ 9.8
1 to 2 years	950	4.9
2 to 3 years	1,377	4.0
3 to 5 1/2 years	<u>1,694</u>	<u>5.3</u>
Totals	4,739	\$24.0

Documentation Supporting Accounts Payable and Obligations. The validity of many unliquidated obligations could not be determined. Our sample consisted of 67 accounts payable (with balances of at least \$100,000) totaling \$24.5 million. In the sample, DFAS Denver Center personnel could not locate any documentation to support obligations for 29 accounts payable totaling \$8.9 million. DFAS Denver Center personnel attributed the absence of documentation to the transfer of the DAO from Headquarters, DIS, to the DFAS Denver Center.

Review of Available Documentation. Review of the available documents for the remaining 38 sample items (67 minus 29), valued at \$15.6 million, and discussions with DIS and DFAS Denver Center personnel, showed that the unliquidated obligations should be deobligated or that uncertainty existed regarding the liabilities and obligations. Discussion with a DIS funds certification official disclosed that at least 9 of the unliquidated obligations and accounts payable, totaling \$1.5 million, were not valid, and the funds should be deobligated. (Of the \$1.5 million, \$1.2 million were obligations from FYs 1993 through 1996 Operation and Maintenance appropriations. When deobligated, those funds could be used for adjustments to valid obligations, if needed.) For the remaining 29 of the 38 sample items, DIS and DFAS Denver Center personnel were uncertain about the validity of the unliquidated

obligations and accounts payable. DIS had not established centralized internal controls to determine whether the required goods or services had been received.

Payroll-Related Liabilities

The Open Document Listing as of May 31, 1997, showed liabilities of \$27.7 million for payroll expenses and related benefits for FYs 1992 through 1996 Operation and Maintenance appropriations. However, neither DIS nor DFAS Denver Center personnel could provide documentation to support these liabilities. Payroll expenses are accrued during the year earned, and should be paid and recorded in accountable records shortly after they are accrued.

Payroll Liabilities for FY 1996 Expenses. Included in the \$27.7 million of payroll liabilities was \$25.9 million of FY 1996 payroll expenses and related benefits. However, a review of the May 31, 1997, Open Document Listing showed that some payrolls had not been posted. During FY 1996, the DIS payroll was converted to the Defense Civilian Pay System. Before the conversion, DFAS personnel at Headquarters, DIS, manually posted payroll obligations, accruals, and payments (by Bolling Air Force Base, Washington, DC, and Dobbins Air Force Base, Marietta, Georgia) to the BQ system. However, manually prepared summary sheets by DFAS personnel showed that at least three biweekly payrolls processed by Dobbins Air Force Base and nine biweekly payrolls processed by Bolling Air Force Base were never entered into the accounting records. As a result, the payroll liabilities were overstated by the amounts of payroll paid but unrecorded for the missing pay periods. Other posting errors may also have occurred. Neither DFAS Denver Center nor DIS personnel could provide the supporting documentation for payroll obligations and payments.

Documentation for other payroll-related liabilities and obligations also could not be located. For example, neither DIS nor DFAS Denver Center personnel could provide documentation to support \$1.8 million in obligations and liabilities for FY 1996 Variable Separation Incentive Pay.

Neither DIS nor DFAS Denver Center personnel could find records to show how much of the \$25.9 million in FY 1996 obligations for payroll-related liabilities had been paid. DIS and DFAS Denver Center personnel attributed the missing documentation and failure to post payroll payments to the move of the DAO from Headquarters, DIS, to the DFAS Denver Center.

Payroll Liabilities for FYs 1992 Through 1995 Appropriations. The May 31, 1997, Open Document Listing also included payroll-related liabilities of \$1.8 million for FYs 1992 through 1995 appropriations. However, neither DIS nor DFAS Denver Center personnel could provide any supporting documentation for these outstanding balances. DIS allowed small unliquidated obligations for payroll-related items to remain in the records until the

appropriations were canceled.² For example, on May 9, 1997, DIS instructed DFAS Denver Center personnel to delete \$2.3 million of obligations for payroll-related obligations and liabilities for appropriations that had been canceled. DIS should not wait until appropriations are canceled before deobligating unsupported obligations. In the absence of supporting documentation, liabilities and obligations should be deobligated and the funds put to better use. Of the \$1.8 million, \$1.4 million represented funds from FYs 1993 through 1995 appropriations. When deobligated, those funds could be used for adjustments to valid obligations, if needed.

Travel-Related Liabilities and Obligations

On the May 31, 1997, Open Document Listing, recorded liabilities and obligations of \$10.8 million for travel-related expenses from the FYs 1992 through 1996 appropriations were overstated and unsupported. This occurred because DIS had not established internal controls to review the validity of liabilities accrued for travel. The existence of invalid liabilities and unliquidated obligations in accounting records also prevented funds from being put to better use.

Testing of Travel-Related Liabilities. Our judgment sample of 46 travel accounts, with liabilities totaling \$621,152, showed the following.

- o Obligations for one account, totaling \$7,046, were valid and were awaiting movement of household goods.
- o Documentation for 11 accounts, totaling \$138,849, showed that travel had been completed and reimbursements paid. DIS personnel agreed that the liabilities were not valid and that these funds can be put to better use.
- o Documentation for 11 accounts, totaling \$101,611, was for the movement of household goods on Government Bills of Lading. However, DIS did not have Government Bills of Lading to show what the liabilities should be, and had not determined whether the obligations were valid.
- o DIS could not find any documentation to support 23 accounts totaling \$373,646.

Dormant Travel-Related Liabilities. Of the \$10.8 million in recorded liabilities and obligations from FYs 1992 through 1996 appropriations, for accounts totaling \$10.6 million, no transactions had been posted for 120 days to 5 1/2 years, as shown in Table 2.

²Appropriations are canceled by the U.S. Treasury, 5 years after obligation authority expires, in accordance with Title 31, United States Code, Sections 1551-1557.

Table 2. Travel-Related Liability Accounts With No Transactions

<u>Time With No Transactions</u>	<u>Number of Accounts</u>	<u>Liability (millions)</u>
120 days to 1 year	646	\$ 3.6
1 to 2 years	767	2.5
2 to 3 years	913	2.0
3 to 5 1/2 years	<u>1,016</u>	<u>2.5</u>
Totals	3,342	\$10.6

Because of the large number of accounts with no transactions, it is probable that after review by DIS, funds from some of those dormant accounts can be deobligated and put to better use.

Accounting Responsibility. The DAO at Headquarters, DIS, was responsible for accounting for travel obligations and posting disbursements before November 1996, when the office moved to the DFAS Denver Center. It is not clear what procedures, if any, the DAO used to monitor the validity of travel obligations and liabilities. When the DAO closed and its functions moved to the new office at the DFAS Denver Center, DIS took over the responsibility for accounting for travel-related obligations and liabilities. However, at the time of the audit, DIS personnel were focusing on FY 1997 obligations to ensure that obligations for that year were valid and accurate before the fiscal year ended on September 30, 1997. DIS personnel were not researching or attempting to validate obligations and liabilities for prior years. As shown previously in the report, DoD policy requires DIS to validate dormant accounts. Invalid obligations from dormant accounts should be removed from accounting records and the funds put to better use.

Duplicate Obligations

A judgmental sample of 36 unliquidated obligations for FY 1997 appropriations shown on the May 14, 1997 Open Document Listing disclosed \$761,572 in duplicate obligations. In October 1996, DIS obligated about \$1 million for telecommunications expenses for its Headquarters and four regional offices, but when vendors submitted invoices for payment, DFAS Denver Center personnel could not locate the files showing the obligations. Therefore, DFAS Denver Center personnel requested that DIS provide obligations to support the vendor invoices. A DIS official prepared and sent duplicate obligating documents to the DFAS Denver Center, which then created duplicate obligations in the Open Document Listing. Table 3 shows that 5 of the 36 items sampled were for duplicate obligations.

Table 3. Duplicate Obligations for FY 1997 Telecommunications Services

<u>DIS Region</u>	<u>Duplicate Amount</u>
Headquarters	\$ 140,711
Capital Area	114,534
Central	161,261
Pacific	138,623
Northeast	<u>206,443</u>
Total	\$761,572

As a result, DFAS unnecessarily obligated at least \$761,572 of DIS funds that could be put to better use. DIS and the DFAS Denver Center should establish internal controls to prevent duplicate obligations from being posted to accounting records. The duplicate obligations occurred during the period that the DAO at DIS was being closed and transferred to the Finance and Accounting Operations Directorate at the DFAS Denver Center. However, DIS personnel stated that the establishment of duplicate obligations by the DFAS Denver Center was a continuing problem.

Accrued Annual Leave Payable

The DFAS Denver Center and DIS did not have procedures for reporting the unfunded liability for FY 1996 for accrued annual leave payable, and the annual expenses for annual leave earned, to the DFAS Indianapolis Center. As of April 26, 1997, the unfunded liability for annual leave earned but not taken was \$11.8 million. DoD 7000.14-R, the "DoD Financial Management Regulation," volume 4, January 1995, states that the accrual of annual leave is material and shall be recognized annually by DoD Components in accounting records and financial statements.

Accounts Receivable

Accounts receivable shown in the Open Document Listing for DIS were delinquent and not supportable, and DFAS Denver Center personnel were not performing required followup actions on delinquent accounts receivable.

Adequacy of Documentation. Of the 72 accounts receivable totaling \$4.6 million shown on the April 10, 1997, Open Document Listing, DFAS Denver Center personnel had no documentation to support 16 accounts valued at \$1.3 million. In addition, accounting personnel could not provide sufficient documentation to support 2 accounts receivable, totaling \$524,289, that were included in our judgment sample of 15 accounts. They believed that the failure

Financial Accounting and Reporting

to locate supporting documentation for the \$1.8 million in accounts receivable was due to the transfer of the DAO from Headquarters, DIS, to the DFAS Denver Center.

Delinquent Accounts Receivable. DFAS Denver Center personnel did not follow up on delinquent accounts receivable for DIS, as required by DFAS Denver Center Regulation 177-102, "Commercial Transactions at Base Level," January 31, 1996. The regulation requires the billing activity to issue two collection followup letters within 120 days after the original billing date. Receivables that remain uncollected after 120 days should be referred to a DFAS Center for collection assistance. Of the \$4.6 million in accounts receivable shown on the Open Document Listing, \$1.7 million had been on the listing for 4 months to over 4 1/2 years with no collections recorded. Our judgmental sample of 15 accounts receivable, totaling \$2.6 million, included 4 accounts, totaling \$402,000, that were delinquent over 120 days. However, no collection followup letters had been sent for these accounts in 1996 or 1997. DFAS Denver Center personnel stated that they had not sent followup letters for DIS accounts receivable because the DFAS Denver Center was focusing on larger delinquent accounts receivable in its customer base. When that work was completed, the Director, Finance and Accounting Operations Directorate, DFAS Denver Center, planned to begin followup work on smaller accounts receivable.

Reporting Financial Information for DIS

DFAS Denver Center personnel who performed accounting services for DIS did not provide the DFAS Indianapolis Center with a trial balance for DIS at the end of FY 1996, as required,³ because financial information for DIS was not maintained on a standard general ledger showing assets, liabilities, revenues, and expenses. Therefore, DFAS Indianapolis Center personnel prepared a trial balance based on information from the September 30, 1996, "Report(s) on Budget Execution." The "Report(s) on Budget Execution" are based on budgetary information and do not give detailed account information, such as categories of operating expenses or liabilities. For example:

- o The DFAS Indianapolis Center showed \$203 million in direct expenses included in the "Report on Budget Execution" as Contractual Services, although DIS accounting records showed that \$148 million of those expenses were for payroll-related expenses.

- o The DFAS Indianapolis Center showed \$120 million as Accounts Payable, based on liabilities shown in the "Report on Budget Execution."

³ A DFAS Indianapolis Center memorandum, "General Ledger Reporting for the Department 97 Appropriations," June 25, 1995 required organizations that perform accounting functions for Department 97 funds to submit monthly trial balances to the DFAS Indianapolis Center in FY 1996.

However, the Allotment Ledger from the BQ system showed that \$52 million of those liabilities should have been reported as Accrued Payroll and Benefits.

Until the DFAS Denver Center provides the detailed information required in a standard trial balance, financial statements for DIS will not accurately present the financial position and results of operations. A subsequent audit report will make recommendations to organizations that do not submit trial balances to the DFAS Indianapolis Center as required.

Conclusion

We identified significant problems in the reliability and supportability of obligations and liabilities for accounts payable, payroll-related expenses, and travel-related expenses. Of particular concern was the absence of any documentation to support \$13 million⁴ in obligations and \$1.8 million in accounts receivable that were included in audit samples taken from the BQ system. The absence of documentation may be related to the closure of the DAO at Headquarters, DIS, subsequent accounting for DIS by the newly established Accounting and Financial Operations Directorate at the DFAS Denver Center, and transfer of the accounting function for travel to DIS personnel. At the DFAS Denver Center, internal controls over the processing of current transactions were improving. However, DFAS Denver Center personnel had not corrected errors made in prior years in recording liabilities. Also, DFAS Denver Center personnel had not been able to locate missing documentation apparently lost during the move from Headquarters, DIS.

The DFAS Denver Center performs the accounting function for DIS, except for travel. However, locating the large amount of missing documentation, correcting discrepancies in accounting records, and the absence of adequate internal controls will require a concentrated effort by both DIS and DFAS Denver Center personnel working together.

Despite the limited nature of this audit and the absence of supporting documentation, we identified \$4.2 million in invalid obligations against FYs 1992 through 1997 Operation and Maintenance appropriations. Included in the \$4.2 million was \$3.5 million in obligations from expired appropriations from FYs 1993 through 1997 that could be used for adjustments to valid obligations: \$1.2 million in accounts payable, \$1.4 million in payroll-related liabilities, \$0.1 million in travel-related liabilities, and \$0.8 million in duplicate obligations. DFAS Denver Center and DIS should be able to identify additional invalid obligations when missing documentation for unliquidated obligations is found and dormant obligations are researched for validity.

⁴The \$13 million in obligations included \$9 million in accounts payable, \$1.8 million in payroll-related obligations for FYs 1992 through 1996 appropriations, \$1.8 million in Variable Separation Incentive Pay for FY 1996, and \$0.4 million in travel-related liabilities.

Recommendations for Corrective Action

1. We recommend that the Director, Defense Finance and Accounting Service Denver Center, in conjunction with the Director, Defense Investigative Service:

a. Establish internal controls to periodically validate all unliquidated obligations and liabilities, as required by the Under Secretary of Defense (Comptroller) policy memorandum "Quality Reviews of Commitments and Obligations," May 14, 1996, and remove obligations that cannot be validated.

b. Locate or reconstruct missing documentation to support unliquidated obligations and accounts receivable.

c. Locate and record appropriate payment information for outstanding liabilities for FY 1996 payroll expenses and related benefits, and deobligate remaining amounts that are not supported.

d. Determine the validity of recorded accounts receivable and delete accounts that cannot be documented.

e. Establish internal controls to prevent duplicate obligations from being posted to accounting records.

f. Report the unfunded annual leave liability to the Defense Finance and Accounting Service Indianapolis Center, along with the annual expenses for annual leave earned during the year, as required by DoD 7000.14-R, the "DoD Financial Management Regulation," volume 4, January 1995.

2. We recommend that the Director, Defense Investigative Service, determine the validity of unliquidated obligations for travel-related expenses, remove obligations and liabilities that cannot be supported, and establish internal controls to ensure that obligations and liabilities for travel are accurate and periodically reviewed as required.

3. We recommend that the Director, Defense Finance and Accounting Service Denver Center:

a. Adjust liabilities (accrued expenditures unpaid) incorrectly recorded in the Air Force Base Level General Accounting and Finance System for the Defense Investigative Service, to reflect only accruals for goods and services received.

b. Use existing procedures to follow up on delinquent accounts receivable, as established by Defense Finance and Accounting Service Denver Center Regulation 177-102, "Commercial Transactions at Base Level," January 31, 1996.

Management Comments Required

A draft of this report was issued on November 5, 1997. No management comments were received. Therefore, we request that the Defense Finance and Accounting Service Denver Center and the Defense Investigative Service provide comments on this final report.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

We reviewed the DIS financial statements for FY 1996 and verified that the information submitted to the DFAS Indianapolis Center was included in the FY 1996 financial statements. We also reviewed DIS and DFAS Denver Center accounting policies and procedures for recording information in the BQ system and verified that the amounts for applicable accounts in the March 31, 1997, Allotment Ledger for DIS were correctly shown in the "Report(s) on Budget Execution."

We limited reviews of transactions and account balances to the Operation and Maintenance appropriations because 95 percent of appropriations received by DIS during FYs 1996 and 1997 were from Operation and Maintenance appropriations. Also, we did not include reviews of transactions and accounting procedures for funds that DIS suballocated to the Defense Polygraph Institute, Fort McClellan, Alabama, because those funds were less than 1 percent of DIS appropriations during FY 1996.

Total reported liabilities for DIS as of May 31, 1997, were \$86.2 million. Included in that total were \$74.7 million in liabilities for the FYs 1992 through 1996 Operation and Maintenance appropriations. We took judgment samples of \$52.8 million of the \$74.7 million to determine its validity and supportability. DFAS Denver Center and DIS personnel did not provide documentation to support any of the \$52.8 million in liabilities sampled. The following table shows reported and sampled liabilities and the basis of the samples.

**Reported Liabilities for FYs 1992 Through 1996 Appropriations
as of May 31, 1997, and Liabilities Sampled**

Type of Liability	<u>Total Reported</u>		<u>Total Sampled</u>		<u>Basis of Sample</u>
	<u>Amount</u> <u>(millions)</u>	<u>Items</u>	<u>Amount</u> <u>(millions)</u>	<u>Items</u>	
Accounts Payable	\$36.2	5,073	\$24.5	67	All accounts > \$100,000
Payroll-Related	27.7	502	27.7	502	All accounts
Travel-Related	<u>10.8</u>	<u>3,364</u>	<u>0.6</u>	<u>46</u>	Selected accounts > \$2,500 from all FYs
Totals	\$74.7	8,939	\$52.8	615	

We reviewed 15 accounts receivable totaling \$2.6 million, shown on the April 10, 1997, Open Document Listing that included \$4.6 million in accounts receivable from FYs 1992 to 1997 appropriations, to determine whether documentation existed to support the accounts and actions were taken to collect the accounts.

We reviewed all of the 36 unliquidated obligations over \$100,000, totaling \$15.8 million for FY 1997 Operation and Maintenance appropriations shown on the May 14, 1997, Open Document Listing to determine whether documentation existed to support the obligations. A total of \$18.6 million in unliquidated obligations was shown on the Open Document Listing for the FY 1997 Operation and Maintenance appropriation.

Because this audit was not intended to provide an overall opinion on the reported balances in financial statements, we did not perform comprehensive reviews or statistical sampling of transactions supporting the balances in the BQ system. Also, we did not project the results of our judgment sampling of account balances.

Computer-Processed Data. We used computer-processed data in the Open Document Listings and Allotment Ledgers from the BQ system for balances of obligations, liabilities, and receivables. This information was not reliable because significant amounts of supporting documentation were missing, and because DFAS did not correctly record liabilities in prior years, based on accrual of goods and services. Details regarding the absence of supporting documentation and accounting errors are discussed in the audit report.

Audit Period, Standards, and Locations. We performed this financial-related audit from April through October 1997. The audit was performed in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the IG, DoD, based on the objectives of the audit and the limitations in the scope described in this appendix. Accordingly, we included such tests of internal controls as were considered necessary.

Audit Contacts. The audit was performed at Headquarters, DIS, and the DFAS Denver Center.

Internal Control Program

DoD Directive 5010.38, "Internal Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement comprehensive systems of management controls that provide reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Internal Control Program. We reviewed the adequacy of DIS and the DFAS Denver Center's controls over the reliability of financial information in the BQ system, including unliquidated obligations, liabilities, and accounts receivable. We also reviewed management's self-evaluations applicable to those controls.

Adequacy of Internal Controls. We identified material internal control weaknesses, as defined by DoD Directive 5010.38, at DIS and the DFAS Denver Center. DIS personnel did not adequately review travel-related liabilities, and DFAS Denver Center personnel did not adequately review financial information in the BQ system. Internal controls at the DAO at DIS,

Appendix A. Audit Process

which closed in November 1996, had material weaknesses in controls over documentation for obligations and receivables. The Finance and Accounting Operations Directorate at the DFAS Denver Center was established in FY 1997 and was not fully staffed at the time of our audit. Although the Directorate had an internal control plan, accounting personnel had not been able to completely implement effective internal controls to validate balances and transactions from prior years during the first months of operation. Recommendations in this report, if implemented, will ensure that DIS and the DFAS Denver Center can document and properly account for obligations, liabilities, and accounts receivable.

The lack of adequate internal controls by the DFAS Denver Center and DIS caused funds of at least \$4.2 million from the Operation and Maintenance appropriation for FYs 1992 through 1997 to be overobligated. Those funds could have been put to better use. An undetermined amount of additional funds can be put to better use when DIS and the DFAS Denver Center locate missing records and validate remaining unliquidated obligations. A copy of this report will be provided to the senior officials in charge of internal controls at DIS and the DFAS Denver Center.

Adequacy of Management's Self-Evaluation. DIS officials did not identify accounting and finance functions as assessable units; therefore, they did not identify or report the material internal control weaknesses identified by the audit. DIS officials were identifying assessable units as part of restructuring the internal control program, but the proposed inventory of assessable units did not include accounting and finance. The internal control program of the DFAS Denver Center's Finance and Accounting Operations Directorate did not identify the material weaknesses identified in the report because the Directorate and its program were in their infancy and the planned reviews had not been performed.

Appendix B. Summary of Prior Coverage

IG, DoD, Report No. 97-110, “Material Accounting and Management Control Weaknesses in the Defense Agencies’ FYs 1995 and 1996 Financial Information,” March 17, 1997.¹ The report summarized accounting system and internal control weaknesses identified during audits of Defense agencies’ FYs 1995 and 1996 financial data. The report states that the Defense agencies’ FYs 1995 and 1996 accounting system weaknesses were primarily related to four key accounting requirements:

- o general ledger controls and financial reporting;
- o property and inventory accounting;
- o system controls (fund and internal); and
- o accrual accounting.

The audits also identified weaknesses in the Defense agencies’ accounting systems in six additional key accounting requirements: accounting for receivables, including advances; audit trails; cash procedures and accounts payable; system documentation; system operations; and user information needs. Consequently, general ledger account data were not reliable and may adversely affect the accuracy and reliability of the Defense agencies’ financial statements.

The Defense agencies took aggressive actions to correct certain material weaknesses in FY 1994 in accounting systems and management controls. However, actions to correct other weaknesses were in process, had not been started, or may not be completed until FY 1998 at the earliest. The DoD management improvement initiatives will significantly improve the accuracy and integrity of financial and related information. However, several initiatives need to be tested and implemented to fully measure their success. The report made no recommendations.

IG, DoD, Report No. 95-INS-15, “The Defense Investigative Service,” September 21, 1995. The report was on a comprehensive inspection that covered all major DIS functions. Included in the report was a finding related to the DIS management control program. The report states that DIS did not include core functions, including finance, accounting, and budget as assessable units in its management control program. DIS managers were not formally designated as assessable unit managers, and the position descriptions did not include responsibility for the success or failure of management controls. The report recommended that DIS identify and include all core functions as

¹The audit report does not discuss accounting for DIS. However, problems identified in other Defense agencies are similar to problems identified during the audit of financial accounting for DIS.

Appendix B. Summary of Prior Coverage

assessable units in its management control plan, that assessable unit managers be formally designated, and that management control responsibilities be included in position descriptions and performance plans and evaluated in performance appraisals. The Director, DIS, generally concurred and stated that an Internal Management Control Steering Committee was identifying all DIS assessable units and that other recommendations had been or would be implemented.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Command, Control, Communications and Intelligence)
Assistant Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Denver Center
Director, Defense Investigative Service
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

Audit Team Members

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